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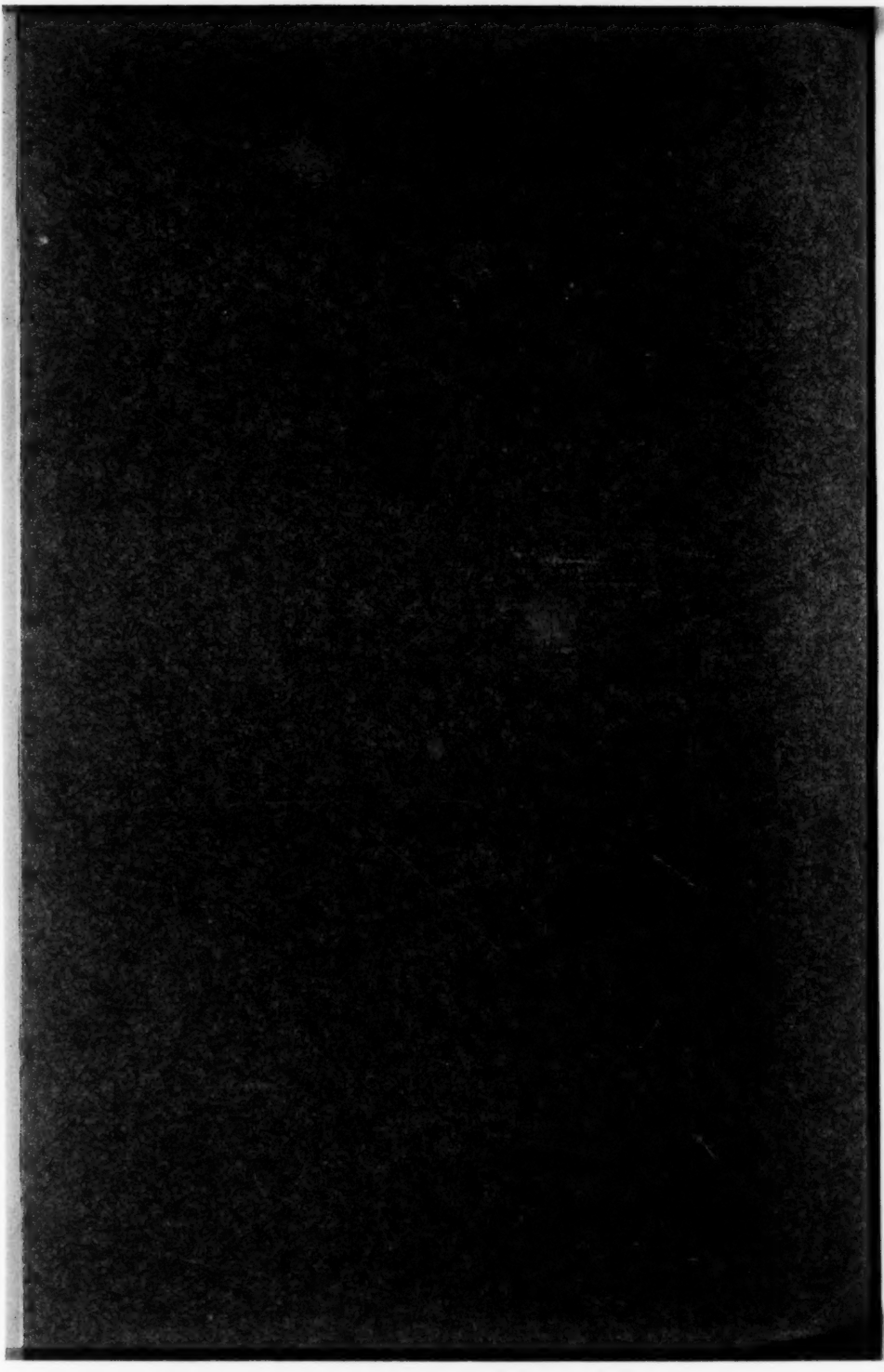

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430028—41

In the Supreme Court of the United States

OCTOBER TERM, 1941

No. 741

SKENANDOA RAYON CORPORATION, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 65–95) is reported in 42 B. T. A. 1287. The opinion of the Circuit Court of Appeals (R. 128–131) is reported in 122 F. (2d) 268.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on August 16, 1941 (R. 131–132). The petition for a writ of certiorari was filed November 14, 1941. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Pursuant to taxpayer's "Plan of Recapitalization" and reorganization, holders of taxpayer's 7 per cent preferred stock, of no par value, exchanged that stock for 1.4 shares of new 5 per cent preferred stock, of $100 par value, and $5.50 in cash, surrendering their right to unpaid accumulated dividends of $45.50 per share on the old stock.

The question is whether a dividends paid credit, except for the cash paid, is allowable under Section 27 of the Revenue Act of 1936. This depends upon whether the transaction was an exchange of stock for stock in a reorganization or was a dividend paid.

STATUTE INVOLVED

The applicable sections of the statute are set out in the appendix, *infra,* pp. 9–14.

STATEMENT

The facts found by the Board (R. 66–83) may be summarized as follows:

Prior to July 1, 1937, taxpayer, a Delaware corporation, had outstanding 5,632 shares of 7 per cent cumulative preferred stock, without par value, upon which dividends of $45.50 per share were in arrears on July 1, 1937 (R. 66–67). During the year 1937, the corporation made net profits of more than enough to pay the arrears of dividends on its preferred stock but it desired to retain funds for expansion of the business (R. 67).

In April, 1937, the taxpayer devised a plan of recapitalization (R. 67). Stockholders were notified by circular letter (R. 67–69) and a printed copy of the plan, designated "Plan of Recapitalization" (R. 69–74) was sent to all stockholders (R. 67). Under the plan, preferred stockholders were offered $5.50 cash and 1.4 shares of new 5 percent preferred stock, of a par value of $100, in exchange for one share of old preferred stock (R. 71–73) on the understanding that by accepting the plan and exchanging the preferred stock any claim to dividends accrued and in arrears would be released, relinquished and discharged (R. 73). Common stockholders were to receive common stock of a par value of $5 for each share of no par common stock held (R. 70).

The offer was accepted by holders of all but 79 shares of the old preferred stock and in July 1937, the directors declared the plan of recapitalization operative (R. 76). The plan was thereupon carried out and the holders of 5,553 shares of the old preferred stock, then reclassified into the same number of Class A preferred, surrendered their certificates and received 7,774.2 shares of the new cumulative prior preferred stock and $30,541.50 in cash, at the rate of $5.50 for each old share surrendered. The holders of 79 shares of old preferred then held the same number of shares of Class A preferred and the holders of 343,542 shares of common stock of no par value became holders of a

similar number of shares of reclassified common stock of a par value of $5 per share (R. 79).

In connection with the preparation and carrying out of the "Plan of Recapitalization", the taxpayer paid its attorneys $15,000 (R. 82).

The Commissioner, in auditing the tax return filed for the year 1937, allowed the taxpayer's claim of a dividends-paid credit to the extent of $5.50 cash per share paid on the old preferred stock, $30,541.50, but denied the claim of a credit for $222,120 (representing $40 per share on 5,553 shares of the old preferred stock). He also denied a dividends-paid credit of $3,160, representing $40 per share on the 79 shares of stockholders who did not consent to the plan, but abandoned that position on brief. He disallowed the deduction of $15,000 for attorneys' fees on the ground that it was a capital expenditure. (R. 83.)

The Board held that the transaction was a nontaxable exchange and therefore no dividends-paid credit, other than that allowed and conceded by the Commissioner, was allowable to the taxpayer (R. 95). It also held that attorneys' fees were a capital expenditure and not deductible (R. 95). The court below affirmed (R. 128–132).

ARGUMENT

The only question presented to the Board of Tax Appeals was whether in effect the transaction was a payment of a cash dividend (R. 85). The Board

held that the transaction was an exchange of old stock for new, plus cash, that the transaction was a nontaxable exchange, and that therefore, no dividends-paid credit was allowable.[1]

1. The Circuit Court of Appeals agreed with the Board that the transaction was a tax-free exchange as an incident to a reorganization by recapitalization (R. 129). Since Section 112 (g) (1) (D) defines the term "reorganization" to include a recapitalization, it is plain that the transaction was a tax-free exchange. But in any event, the mere fact that the transaction was an exchange, whether taxable or not, is a sufficient answer to the taxpayer's contention that a payment of a dividend was here involved.

The holding of the court below, therefore, that the item in dispute was not a taxable dividend but, rather, was a tax-free exchange (R. 129) was, without more, dispositive of the case. Nevertheless, the court below took cognizance of additional arguments advanced by the taxpayer relating to the issue whether, assuming that the transaction were not a tax-free exchange, the stockholders received taxable income (R. 130). On this issue too, the court below held against taxpayer, and, accord-

[1] The Commissioner allowed a dividends-paid credit to the extent of the $5.50 cash paid on each old share and to the extent of $40 additional per share paid to the nonassenting old stockholders (R. 83). These credits are not involved here.

ingly, petitioner seeks further review in this Court on the ground that the decision of the court below in this respect is in conflict with *Eisner* v. *Macomber,* 252 U. S. 189, *Koshland* v. *Helvering,* 298 U. S. 441, and *Helvering* v. *Gowran,* 302 U. S. 238 (Pet. 9–12; 29–30). But whatever the difficulties arising from these cases, it is clear that they are not material since their application does not relate to the holding of the court below. Those cases involved dividends; in the instant case, as the court below held, there was no dividend but only a tax-free exchange.

2. The other grounds urged by petitioner are equally without merit. Petitioner's contention (Pet. 18–26) that the transaction was a distribution of a cash dividend is based on a factual premise explicitly rejected by the Board of Tax Appeals and the court below. Although there was a single transaction whereby 1.4 new shares plus $5.50 in cash were issued for each old share, taxpayer contends for an allocation of the additional .4 share to the accrued dividends on the old shares. The concurrent findings (R. 90, 130) below that the transaction was single and indivisible are clearly correct and require no further review.

Petitioner also urges (Pet. 26–32) that the additional .4 shares of new stock should be considered either as a cash dividend or as a stock dividend. The court below adequately answered both contentions. It pointed out (R. 130) that no election was

given to the stockholders to take either cash or stock and that there was therefore no basis for regarding the distribution as a cash dividend. With respect to the alleged stock dividend, the Circuit Court of Appeals pointed out that a holding to that effect would be no aid to the taxpayer since it had failed to prove the value of the stock (R. 131). The question of value was pointedly brought to the taxpayer's attention in the Board hearing (R. 122), and hence the failure to show the value was not an inadvertence.

Petitioner's contention that the transaction was not a tax-free exchange (Pet. 32–38) is mistakenly based on Section 112 (c) (2) of the Revenue Act of 1936. That provision deals exclusively with the portion of the consideration which is made taxable by Section 112 (c) (1). Thus Section 112 (c) (2) deals only with money or property other than stock or securities and is not applicable to the additional stock issued in the exchange here involved.

Taxpayer's final contention that the legal expenses incurred in carrying out the exchange are deductible depends upon the acceptance of its theory that this transaction was a taxable dividend. Since it was not, the legal expenses clearly are not deductible.

CONCLUSION

The decision of the court below that the transaction was a tax-free exchange in reorganization is correct and presents no question of general im-

portance. The only conflict asserted by petitioner relates to a dictum of the court below. The petition should therefore be denied.

Respectfully submitted.

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DECEMBER 1941.